CITY OF HAYWARD
AGENDA REPORT

AGENDA DATE 12/18/01
AGENDA ITEM 5
WORK SESSION ITEM _____

TO: Mayor and City Council

FROM: City Manager

SUBJECT: Request For Proposals To Engage A Consultant To Evaluate the Formation of an Electric Utility Owned by the City

RECOMMENDATION:

It is recommended that the City Council approve the issuance of a Request for Proposals (RFP) soliciting consulting firms to assist the City in evaluating its options for forming an electric utility owned by the City.

BACKGROUND:

During the course of its deliberations earlier this year regarding the Russell City Energy Center, the City Council requested that staff explore the formation of a mechanism that would enable the City to be engaged in the business of providing electricity to residents and businesses in Hayward. As a result, last October, staff presented to the City Council in study session a report providing a summary and overview of the available options. This report (Attachment A) recommended that, if the City desires to be in the business of providing electricity, the formation of a utility would be the most advantageous mechanism to do so.

The City Council concurred and directed the staff to prepare an RFP to retain a consultant to assist the City in more fully analyzing the legal, engineering, economic, and financial feasibility of forming an electric utility. This RFP has been prepared, and is on file in the City Clerk's Office.

Attachment B is the Scope of Work for this RFP. The scope of work is divided into two phases:

Phase I - Background Research and Determination of Market Feasibility

Phase II - Identification of Options and Development of a Detailed Business Plan

The scope of work is structured so that the consultant who performs the work will complete the tasks under Phase I, and present the results of those tasks to the City. These results will then

be presented to the City Council along with recommendations from City staff, following which a decision can be made whether or not to proceed with Phase II.

The RFP requests that proposed costs for Phase I be quoted on a "not to exceed basis," and that the costs for Phase II be quoted on a "time and materials basis" with an estimate of the cost and nature of the subtasks which the consultant believes needs to be completed. If a decision is made to proceed with Phase II, it is anticipated that City staff would then negotiate the costs and a more detailed scope of work with the consultant.

If approved, it is anticipated that a consultant firm could be selected and begin its work by March 2002.

Jesús Armas, City Manager

Attachment A: October 16, 2001 Agenda Report –
Review of Options Regarding a Municipal Electric Utility

Attachment B: Scope of Work

ATTACHMENT A

CITY OF HAYWARD
AGENDA REPORT

AGENDA DATE 10/16/01
AGENDA ITEM
WORK SESSION ITEM WS 2

TO: Mayor and City Council

FROM: City Manager

SUBJECT: Review of Options Regarding A Municipal Electric Utility

RECOMMENDATION:

It is recommended that the City Council review and comment on this report.

BACKGROUND:

During the course of its deliberations regarding the Russell City Energy Center ("RCEC"), the City Council requested that staff explore the formation of a mechanism that would enable the City to be engaged in the business of providing electricity to residents and businesses. This report provides a summary and overview of the options available to the City in this regard. An underlying premise is that the operation of the RCEC in Hayward will enable the City to buy electricity wholesale and distribute it on a retail basis, much as is done with our water system.

Formation of an Irrigation District

One option is for the City to form an irrigation district ("District") to engage in the purchase and resale of electricity. The District could consist of City-owned land and the City could offer other landowners, *e.g.* owners of industrial parks, the opportunity to participate in the District. Lands included in the District need not be contiguous. In order to form a District, the City and other participants must be willing to engage in activities that develop, conserve and preserve water for the beneficial use of the District's inhabitants; this is the main purpose of a District. Water for agriculture is no longer a required purpose for formation of a District. The right to distribute and sell power is ancillary to the main purpose of the District. While this option would give the City broad power to engage in the business of buying and selling electricity, as discussed below, the process of forming the District is cumbersome and may not grant the City the autonomy or sufficient revenue to justify its formation.

The formation of a District takes approximately one year. In order to form a District, a petition for formation must be prepared and circulated; the petition must contain a description of the land proposed to be included, a statement as to the source or sources of water supply, and the signatures of the qualified petitioners. After the petition has been prepared and circulated, it must be published. After publication of the petition, a preliminary hearing regarding formation of the District is held before the board of supervisors. If the board determines that the petition is sufficient and adopts a preliminary formation resolution, the resolution is forwarded to the State Department of Public Works ("DPW"). The State DPW then makes a feasibility investigation of the proposed irrigation project and returns a written recommendation to the board. The board has some limited powers to override an unfavorable DPW recommendation. If the board proceeds with the petition, it will hold a final hearing, adopt a final resolution and call for an election of qualified voters residing within the proposed District.

Disadvantages of this option include the time-consuming formation process and that the District may not provide the City with its desired level of autonomy or revenue. A District is not a division of the City even if all of the land that comprises the District is City owned land. Rather, the District is a separate and independent legal entity. The District is limited by statute as to the types of accounts it can establish and the allocation of monies to those accounts. Thus, the District's board cannot simply vote to remit District revenues to the City.

Because this option is cumbersome and would not result in the level of control and revenue the City may desire, staff suggests that this option not be pursued.

Annexation to an Existing Irrigation District

The City may request annexation of certain property to an existing District. Such a request would be made by petition of the titleholder(s) of the property to be annexed to the board of directors of the existing District. Annexed property need not be contiguous to the existing District. The District could then buy power and sell it to inhabitants of its District, the City property included in the District, and to City sites outside of the District as well. A District may sell, dispose of, and distribute electric power for use outside of its boundaries.

A disadvantage of this option is that the City must cede control to the existing District's board. The City's likely representation on the board would be only in that proportion that its property in the District has to the District as a whole. While the City would be able to extract a fee from the existing District in exchange for annexation, ensuing District revenues would not flow directly to the City. In contrast to forming a District, this option has its advantages: it would be relatively quick and painless to complete and does not require an election by any of the City's inhabitants.

Although this option is not as cumbersome as forming a District, in staff's judgment the disadvantages argue for dropping this option from further consideration.

Formation of a Municipal Utility District ("MUD")

Another option available to the City is to form a municipal utility district ("MUD") for the purchase of power and the resale to end users. The City, together with unincorporated territory, or with another public agency, may organize and incorporate as a MUD. Public agencies include cities, county water districts, county sanitation districts and sanitary districts. Public agencies and unincorporated territory included within a MUD may be in the same or separate counties and need not be contiguous. However, no public agency can be divided in the formation of a MUD.

Staff believes that this alternative has basic disadvantages that make it unsuitable for the City's purposes. The City would have to include some unincorporated territory or join with another public agency to form a MUD. Any MUD created would have to include the entire City of Hayward. Finally, a MUD has the same disadvantages to the City as an irrigation district: it is a separate legal entity through which the City would not directly receive any revenue. Therefore, staff recommends that the City Council not consider this option any further.

Formation of a Utility Owned by the City

This option involves the City operating an electric utility to purchase power and to resell it to end users. Of the alternatives staff has researched and analyzed, this is probably the most attractive because it confers broad powers on the City and it is more flexible than other options. However, as discussed below, this option is not without its disadvantages.

The City may acquire or construct facilities to operate an electric utility under California law. The City can then provide power to some or all of its inhabitants. The City can also sell or otherwise distribute excess power outside of the City limits. The City may do whatever is necessary in terms of easements, licenses, etc., to operate the electric utility. The City would have rights of way over roads, streets, etc., for construction and operation of its power lines and would have similar rights of way over state public lands. The City's Charter authorizes the City to form a utility under its general delegation of powers, and could create a department for operation of an electric utility. Under this option, the City could set its own rates for electric power; the rates do not need to be approved by the California Public Utilities Commission ("CPUC"). However, the CPUC would have jurisdiction over the construction and maintenance of the City's electric system, particularly with respect to safety.

In sum, this option has the advantage of providing the City with broad powers to acquire, own and operate a utility to provide electric service and to provide that service to all or any portion of the City, and to sell excess electricity outside of its corporate limits with relatively few restrictions. However, this option also has some disadvantages. For example, if the City wants to use certificates of participation to finance the acquisition of electric facilities, it must hold an election to authorize the debt. The debt must be approved by a majority of the voters voting in the election. Or, if the City ultimately desires to sell its public utility, it must submit

the sale proposal to the City's qualified voters in a special election called for that purpose. The votes of two-thirds of all voters voting at the election are necessary to authorize the sale of a City-owned public utility. A City-owned public utility would also be subject to several other restrictions. For example, the City could not expend any funds for advertising the power it furnishes when the advertising would encourage increased consumption of the service. However, the City may expend funds for advertising if the advertising encourages more efficient use of power or the conservation of energy or natural resources. The City would also be restricted in the means by which it could deal with tenants in both individually metered and master metered multi-unit residential structures, in the imposition of deposits, and in the termination of residential service for nonpayment.

Of all the options set forth in this report, staff believes this option would be the most advantageous for the City. However, staff cautions that formation of a City-owned electric utility is not without some risk, and these should be evaluated before a decision is rendered.

Therefore, if Council supports examining this option in detail, staff suggests that appropriate consultant services be retained to analyze pertinent technical, financial and operational issues. If this analysis is to be pursued, staff would seek formal council action to issue a Request for Proposal for such services.

Jesús Armas, City Manager

Scope of Work

Phase I – Background Research and Determination of Market Feasibility

The purpose of Phase I is to provide the City with a broad contextual understanding of the issues related to the generation and distribution of electrical power, and to make an initial determination of whether or not there exists sufficient market feasibility to encourage the City to further explore its options and proceed with Phase II of this RFP. It is anticipated that the results of Phase I will be discussed with the City Council before a decision is made to proceed with Phase II. Phase I will consist of the following tasks:

1. Provide a background analysis of the federal, state, public utility commission, and other regulatory frameworks of the electric power industry including an analysis of recent industry trends and legislation, and indicate their potential impact on the City's legal, technical, financial and economic ability to generate and/or distribute electricity. This analysis should also take into account the current national and regional dialogue on deregulation, power generation and power distribution including the impact of proposals currently being considered as well as ones likely to be considered. Existing franchises and their attendant current and future obligations should also be taken into account.

2. Research and provide a summary of actions taken or currently being considered by other public agencies comparable to actions and objectives being considered by the City of Hayward.

3. Identify, quantify, and project present and future electric power demand in Hayward and project that demand over the next twenty years, broken down by residential, commercial, and industrial customer market segments. Include in that projection a factor for power quality and reliability taking into account the recent trends and the City's desired continuation for high technology development as well as other trends that might dictate the need for high quality, twenty-four/seven reliability.

4. Identify, quantify, and project present and future supply of electric power, taking into account quality and reliability, and compare the estimated supply to the projected demand to determine (1) whether or not there exists a sufficient excess in demand over supply, (2) whether or not there exists a strategic competitive opportunity, and/or (3) whether or not there exists a particular market niche which could motivate the City to distribute and/or generate power.

Phase II – Identification of Options and Development of Detailed Business Plan

Assuming the City decides to proceed with Phase II, the purpose will be to provide the City with a range of options for achieving its goals, and to develop a detailed business plan for those options selected by the City. Phase II will consist of the following tasks:

5. Devise and prioritize programs the City can undertake to help attain its goal of assuring the existence of reasonably priced, plentiful, reliable, high quality electrical energy over the next several decades. In so doing, the Consultant is asked to assess the *legal, engineering, economic, and financial feasibility* of programs identified. Such programs could include, but would not necessarily be limited to, one or more of the following elements: construction of power distribution and/or generation facilities; sole ownership, co-ownership, lease ownership, or third-party ownership of the facilities; in-house municipal operation or outside third-party operation; leasing of any publicly owned facilities; using techniques of public acquisition; or using tax exempt public financing. The programs undertaken by the City could also include acquiring power from an existing provider, such as an existing municipal utility, and distributing that power through a newly constructed distribution grid or through an existing grid of a third party such as PG&E. The acquisition could be accomplished through a direct purchase contract, a joint powers agreement, or some other form of cooperative association.

6. The *legal analysis* referred to in Item 5 above should follow from and expand upon the research and discussion prepared under Item 1 in this Scope of Work.

7. The *engineering analysis* referred to in Item 5 above should, in addition to other issues the Consultant believes to be relevant, assess the technological feasibility and competitive advantage of:

   a) Existing traditional technologies.
   b) Existing alternative technologies.
   c) Newly developing alternative technologies.

8. The *economic and financial analysis* referred to in Item 5 above should be presented in the form of Long Term Business Plan covering a twenty-year period. In addition to other issues the Consultant believes to be relevant, this plan should include:

   a) A Marketing Analysis performed in conjunction with a market survey of the projected customer base which at a minimum discusses market potential, competitive advantage, existing and potential competition, relevant customer purchasing patterns, pricing, and target market segments.

   b) A Start-Up Plan for the first year of operation showing tasks and milestones, financial requirements, and other relevant issues and projections.

c) A twenty-year Finance and Capitalization Plan showing cash flows; revenue, expense, and profit projections; capital requirements; a break-even analysis; proposed financing techniques; and other relevant analyses.

d) A Risk Assessment providing a straight forward and quantified summary of the financial, economic, technological, and legal risks.

9. Research and make recommendations on the ways in which any excess revenues derived from a newly created power distribution and/or generation system could be used to write down the cost of power purchased by Hayward residents from PG&E.